

PROTOCOL AMENDING PROVISIONS OF INDIA - MAURITIUS DTAA

The India- Mauritius Double Taxation Avoidance Agreement (“Convention”) which was originally concluded between the Government of India and Government of Mauritius in 1982 was recently amended by a Protocol dated 10th May 2016. The detailed Protocol amending the Convention has not yet been released. However, a Press Note briefly explaining the key features of the Protocol has been published. The Protocol was signed by both the countries on 10th May 2016 at Port Louis, Mauritius. The key features of the Protocol are as under:

I. SOURCE BASED TAXATION

A notable feature of this Protocol is a remarkable shift from residence-based taxation to source-based taxation.

(a) Source based taxation of capital gains on shares

- Article 13(4) of the Convention provides that the gains derived by a resident of a contracting state from the alienation of property including shares shall be taxable only in that State.

- This means that if a resident of Mauritius alienates his shares held in an Indian company, then such resident shall be taxable to Mauritian tax in accordance with Mauritian laws. This was the residence based taxation provided under the Convention.

- However, the Protocol envisages a significant shift from the above. Accordingly it ensures that India gets taxation rights on capital gains arising from alienation of shares acquired on or after 1st April 2017 in a company resident in India with effect from financial year 2017-18. A cut off date of 1st April 2017 has been specified which means that all investments made before 1st April 2017 are protection from the provisions of this amendment.

- Another safeguard is the transition period from 1st April 2017- 31st March 2019. During this period the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfillment of the conditions in the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

(b) Source based taxation of interest of banks

- Article 11(1) of the Convention provides that interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. Article 11(3) of the Convention further exempts interest arising in a Contracting State from tax in that State provided it is derived and beneficially owned by any bank carrying on a bona fide banking business which is a resident of the other Contracting State.

- To exemplify this, where a Mauritian resident bank gives loan to an Indian resident. In such a case, the interest arises in India and is finally paid to the Mauritian resident bank. Such interest which arises in India and is paid to the Mauritian resident shall be exempt from any tax in India.

- To change this scenario and to prevent fiscal evasion, the Protocol provides that interest arising in India to Mauritian resident banks will be subject to withholding tax in India at the rate of 7.5% in respect of debt claims or loans made after 31st March 2017.

- Here again, interest income of Mauritian resident banks in respect of debt claims existing on or before 31st March 2017 shall be exempt from tax in India.

II. LIMITATION OF BENEFIT (LOB)

- We had explained in point I(a) above that taxation of capital gains on shares during the transition period from 1st April 2017 to 31st March 2019 shall be limited to 50% of the domestic tax rate in India, subject to fulfillment of the conditions in the LOB article.

- Now, the LOB article provides that a resident of Mauritius (including a shell/ conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test.
- What is the main purpose test and bonafide business test is still unclear and for that we will have to wait for the complete Protocol document.
- However, shell/conduit company has been defined. Accordingly, a resident is deemed to be a shell/ conduit company, if its total expenditure on operations in Mauritius is less than Rs. 27,00,000 (Mauritian Rupees 1,500,000) in the immediately preceding 12 months.

III. EXCHANGE OF INFORMATION ARTICLE

The Protocol provides for updation of Article 26 of the Convention which is the Exchange of Information or Document article. Such updation shall in sync with international standards.

IV. There are other amendments relating to assistance in collection of taxes, source-based taxation of other income and other such changes. It is premature to guess such amendments and we shall wait for the release of complete Protocol document.

Many foreign investors will have to redraw their strategies. The incentive to route investments through Mauritius will cease once the new rule kicks in. Short term foreign investors who were guided primarily by consideration of minimizing taxes will receive a blow to their expectations.. In order to soften their blow to investors, 'grandfathering approach' has been adopted and the amendment has been introduced on a prospective basis. The provisions shall come in to force from 1st April 2017.

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